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Remarks of
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"Regulatory Challenges of The New Energy Economy"

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Ladies and Gentleman:

It is a great pleasure to be in Montreal and to have the opportunity to discuss the future of energy regulation with my distinguished colleagues from Mexico, India, and Canada.

In the interest of time and clarity, let me concede up front that the energy future will invalidate many, if not all, of our assumptions about how to deliver reliable energy, how to protect consumers, how to manage prices efficiently, and what ought to be regulated.

This great conference has already discussed all the variables and the developments that make the future so challenging. From a U.S. perspective, the external forces bearing down on the companies we regulate (or formerly regulated) are: the Internet and e-commerce; new production technologies like the natural gas turbine; the emergence of new market entrants like merchant power producers and value-added resellers; competitive commodity markets; utility diversification, often into non-regulated businesses; the globalization of domestic utility ownership and investments; corporate consolidation; the shift of power from energy sellers to energy buyers; and, last but not least, the renegotiation of the "regulatory compact" between regulated companies and their regulators to accommodate the decline of legal monopolies, new institutions in the market, and dynamic or potentially problematic behaviors by market participants. These are the

essential elements of the energy market transition and each of them deserves a dissertation.

For U.S. regulators and incumbent utility companies, these challenges are enormous and often threatening. They are also complicated by the dispersion of regulatory authority over multiple state and federal agencies. In that regard, the challenges posed by our kind of federalism are no different than those experienced in Canada or the European Union when it comes to developing something called a market that operates according to either the operative commercial realities or the laws of physics and not according to jurisdictional boundaries.

But our's is not the only legitimate perspective on what energy regulation must become in the 21st century. Privatization of successful (and often dismally unsuccessful) state monopolies dominates energy policy

in some counties. The energy future elsewhere in the world often involves finding ways to attract the capital necessary to exploit resources and to create delivery infrastructures that will most widely, equitably, or profitably distribute natural gas, oil, coal, or electricity. In many of these situations, the most immediate challenge of the future may not be the creation of workable and efficient markets as we in North America mean it, but instead the creation of the financial, technological, and regulatory circumstances that will produce basic services for the citizenry and generate adequate returns for companies and governments alike. In those circumstances, regulation remains not only the surrogate for competition, as it was in the United States during the 20th century, but the engine of economic development and supplier of social benefits. And that paradigm, with utility services regarded as a public good requiring control and oversight, will continue to be applied at least until such time as

economic forces can compete to serve the public interest in equivalent ways without the need for government intrusion. Cost-of-service rates and command-and-control regulation are therefore neither inappropriate nor out of vogue everywhere. Our own state regulatory commissions, tied as their mission necessarily is to monopoly service territories, service obligations, social benefit programs, and the local politics of consumer protection, will have a tougher time moving away from that model.

So, where competitive markets are not an issue, new regulatory institutions face very basic issues. For example, in many developing countries, regulators are focused on establishing their agencies' independence, promoting economic stability and supporting investor confidence, setting rates and strict standards of conduct, and even central planning.

In countries where the future involves actively tapping the competitive potential of less regulated energy markets, regulators are often engaged in orchestrating a transition to competition. In addition, energy markets pose unique challenges as they expand beyond their traditional boundaries. In North America, gas and electricity markets are becoming continental. For instance, our Order No. 2000, which encourages the swift development of regional grid management institutions, effectively promotes a view of the electricity grid as commercially and physically integrated across three national borders. Clearly, energy customers are demanding choice and customized services and greater flexibility, and they are likely to receive somewhat greater risk along with those benefits. Environmental protection will become more important to all energy production and consumption decisions. The digital economy will bring a dynamism to energy markets that we have not seen before. Each of these

developments constitutes an enormous change in the energy economy and an attack on a once-serviceable regulatory model that must now be reassessed and renovated.

The challenges for U.S. regulators are therefore quite basic. There looms a troubling question of relevance -- i.e., how to do an effective job for the public interest without being an impediment to operation of markets that are proven competitive.

While the quasi-judicial role of regulatory agencies is the coming fashion and an economic necessity in parts of the world that are still developing their energy infrastructure, that approach to regulation is subject to question in a more competitive environment. Agencies that have traditionally adjudicated rates, for example, are accustomed to being reactive rather than proactive with respect to market developments. They are focused

on due process and fairness more than on market outcomes. And, while very adept at judging facts presented to them, regulatory agencies are clearly less skilled at building consensus and innovating. The "regulatory" skill that, in my view, will soon be in most demand will be negotiation (alternative dispute resolution), generic policymaking, and (for lack of better term) regulation by information –- the gathering and dissemination of real-time market data.

All this adaptive behavior will fill a real need because energy markets will still possess flaws that could compromise critical public interests –- in reliability, for example –- and because the market power of monopoly incumbents will not be so easily expunged from these traditional markets. New regulation, if I can call it that, needs to adapt to re-establish its legitimacy. I believe that current literature and politics might be reasonably interpreted to suggest that

traditional economic regulation is no longer relevant in the West. In other words, there is a question of a loss of consent to be regulated from the industries that historically relied on government intervention to reduce financial risks, fence out new entrants, and to bring order to another chaotic or insufficient marketplace. Will regulated companies continue to accede to the continued exercise of government oversight? Will regulators still deserve the "consent of the governed" in this new environment? The answer is further complicated, first by an erosion of public trust –- at least in the United States –- that government is able to do the right thing, and second by the failure of regulatory agencies to develop or obtain the administrative or technological tools to maintain the technical adequacy of market oversight.

This is a call to action more than gloom and doom for regulators. Regulators in competitive energy

economies must retool to promote reasonably priced and reliable energy services in new ways -- by ensuring the structural integrity and transparency of markets and curbing abuses of market power, as well as by setting rates and so forth. That will involve continuing active oversight of essential networks like long-distance pipelines and electric transmission that have inherent monopoly characteristics and form the essential platform for deregulated energy commodity markets. Moreover, regulators will be instrumental in harmonizing the commercial, legal, and technological realities of interstate and transnational energy markets. At the FERC, modernization has been translated into a bigger investment in information technology, reorganization into a process-centered (and hopefully more efficient) institution, a new customer-orientation, and an emphasis on alternative dispute resolution and market monitoring.

If a less regulated market serves the public interest equitably and still generates wealth, is there still a critical role for energy regulators in the West and even for public policy? I would answer with an unequivocal, yes! But the challenges are great and regulatory agencies are not immune from the consequences of the competitive energy economy they have promoted.

I look forward to our panel discussion.

Thank You